To understand how Washington, D.C.'s fiscally conservative and libertarian-leaning Republicans are handling Treasury Secretary Henry Paulson's proposed $700 billion bailout of the financial services sector, think of a child who's just learned that there is no Easter Bunny. Better yet, think of a guy who sunk his portfolio into Lehman Brothers or Bear Sterns and watched everything he was taught to believe about his investments declared moot, wrong, meaningless, at the mercy of the state.

The bailout "does ensure that President Bush will have a legacy," laughed Fred Smith, the president of the Competitive Enterprise Institute, a staunchly pro-free markets group, on Wednesday. "It's a legacy that will discredit every economic concept that we have on the right. It will set back the concept of economic liberty by a century."

Openly or secretly, a lot of Smith's fellow travelers in the Beltway agree. Three weeks ago in St. Paul, Republicans released a platform that declared flatly, "We do not support government bailouts of private institutions" and that "government interference in the markets exacerbates problems in the marketplace and causes the free market to take longer to correct itself."

Yet as the panic over Wall Street woes has mounted, those principles got lost, and a critical number of Republicans are expected to support a $700 billion bailout of failing investment banks being pushed by a GOP president and his money man. Although serious problems with government-sponsored enterprises such as Fannie Mae and Freddie Mac have long been evident and despite longstanding anxiety about "too-big-to-fail" market players going belly up, the Republicans were caught flat-footed by recent events.

The experience of the most fiscally conservative members of Congress, the Republican Study Committee (RSC), is instructive. Throughout the Bush years, the RSC has proposed alternative budgets heavy on spending cuts. Now, forced to consider a spending package equal to a million earmarks, it was pushed to the side.

Its members did act fast. On Wednesday, September 17, RSC stalwart Rep. Jeff Flake (R-Ariz.) released a forceful statement: "The federal government's propensity to bail out failing companies in struggling industries ought to be troubling to all taxpayers....Aside from the fiscal impact of spending money that the federal government doesn't have, these bailouts will likely have the opposite of their intended effect." Flake also took aim at the then-rumored bailout of the automobile industry.

On Thursday, the RSC sent a public letter to the White House opposing any Wall Street bailout: "Regardless of the precautions taken, the risk to taxpayers and to the long-term future health of our economy remain just too great to justify." But on Friday, RSC Chairman Jeb Hensarling

(R-Texas) put out a tentative, milquetoast statement on the proposed bailout that decried the idea without ruling it out completely. “Though my mind remains open,” Hensarling said, “at the moment I remain skeptical, fearful, and unconvinced that this is the proper remedy for our nation at this time.”

The next day the draft of Treasury Secretary Henry Paulson’s plan was released, with a Tiffany price tag and enumerated powers such as buying up bonds galore and a two-year ban on any real oversight of Treasury’s activity. Former RSC Chairman Mike Pence (R-Ind.) rejected “the largest corporate bailout in American history.”

But other than that: Crickets. Fiscal conservatives mostly dared not come out swinging against a proposal offered by a White House they had, more often than not, trusted.

This past Monday at 5 p.m., the RSC met to strategize further. Who was opposed to the bailout, full stop? Who had alternatives they could put on the table? According to staff who were at the meeting, the mood was somber, with a majority opposed to the concept of a bailout but without a clear idea of how to challenge it. When the full Republican conference met on Tuesday, there was even less unity. At a Heritage Foundation luncheon, Flake told bloggers that about half of his party’s members opposed a bailout.

While Flake was speaking, a dozen members of the RSC were beginning a press conference in the House to make their suggestions and state their positions. Reporters picked up a pithy one-page memo of RSC proposals, including

—a two-year suspension of the capital gains tax, after which “rates would return to present levels but assets would be indexed permanently for any inflationary gains.”

—full privatization of Freddie Mac and Fannie Me “over a reasonable time period.”

—repeal the Humphrey-Hawkins Full Employment Act, which the RSC fingered for the Fed’s suppression of interest rates to artificially low levels (although the Act expired in 2000).

—a suspension of mark-to-market regulatory rules (assigning value to a financial instrument based on the current market price).

That was it. The rest of the press conference was, if not a circus, a carousel with a lot of mis-matching horse heads. Rep. Kevin Brady (R-Texas) suggested that business tax cuts could attract investors to our shores bring more revenue from “profits left stranded overseas." Rep. Joe Barton (R-Texas), a dogged supporter of more oil drilling, claimed that the policies he favored would, conveniently, pull us out of the crisis. “The oil revenues that we could get from ANWR have been scored by the Congressional Budget Office at around $200 billion,” Barton said. Rep. Michele Bachmann (R-Minn.) excitedly agreed with him. ”If we open up these areas for energy exploration, well, Katy bar the door! We’d see this economy turn around immediately!”

Mike Pence, still the only member at the press conference ruling out any yes vote for a bailout, tried to challenge the premise. “There are those in the public debate,” he said, “who have said that we must act now. The last time I heard that, I was on a used-car lot.”

“I would amend that statement,” added Rep. John Shadegg (R-Ariz.). “The last time I saw the phrase 'act now' it was advertising one of those time-share condo deals that lock you in after a free trial period.”

"Did you try it?” asked a reporter.

"No!” Shadegg laughed. But he didn't line up with Pence against any bailout.

The presentation had no notable impact on the debate in Congress. As the Republicans spoke, a few cameramen snickered audibly. When Bachmann called the bailout “the enslavement of the American people,” the snickering reached its loudest pitch. And on the way out, Pence offered reporters more proposals that would probably come to nothing, such as a suspension of the capital gains tax by executive order. "There are learned legal scholars who think that's within his purview as president," Pence explained.

But enough Republicans are ready to support the bailout to make all of this moot. **Rep. John Campbell**
(R-Calif.), an Ayn Rand fan and potential future head of the RSC, conceded that his party is divided. “People are struggling with it around here like you can’t believe,” he told me on Tuesday. “This proposal is anathema to everything I believe. I’ve voted against million dollar bills, and here’s a $700 billion one. But to do nothing—that really threatens a massive expansion of government.”

How so? Campbell doesn’t shy from comparing it to 1929. “If John Q. Lunchbucket doesn’t understand this stuff, and waits in line for a block to get into his bank, and then is told ‘we don’t have your money,’ he will respond to any proposal to prevent that in the future. Any populist who says ‘I’ll make sure these guys never get your money again’ will have his ear.”

There is an external reason for the division of Republicans right now. They don’t control Congress. The Democrats run both houses and are negotiating with the executive branch. They own the agenda. But it is striking how free-market economics have no place in the current debate. They are not seen as a credible response to a Wall Street crisis, even by the presidential nominee of the Republican Party, who is angrily attacking the "greed of Wall Street." Contra Naomi Klein, an economic shock has sent Republicans skittering away from free-market theories; the last thing the party of small government seems interested in letting markets work. The current political debate, not just between Democrats and Republicans but even among Republicans, is not whether the government should take over mortgage firms, but how effectively it can manage them.

“Nobody trusts Republicans on these situations,” said Fred Smith. “For good reasons.”